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Five Financial Snags To Face In A Second Marriage

"Blended" families, once unusual, have become increasingly common. They're typically the result of a divorce, after which one or both ex-spouses remarries, frequently to a husband or wife who also has children from a previous marriage. There are about one million divorces in the United States each year, and it's estimated that almost half of all families today are of the blended variety.

Unfortunately, not every "Brady Bunch" lives in bliss and harmony, and discord is particularly likely after your death. Consider these five areas in which your blended family might face avoidable financial snags.

1. Beneficiary designations. Writing a former spouse out of your will may be at the top of your post-divorce to-do list, but it's also crucial to remember all of the other places you designated your once beloved as primary beneficiary. That may include life insurance policies, retirement accounts, trusts, and annuities. And you likely shouldn't just write in the name of your new spouse. Deciding how and whether your new spouse and your own children share in your estate may involve complicated planning and could mean establishing one or more trusts—and you'll need to coordinate all beneficiary designations with the provisions of your revised estate plan.

2. Tax-free gifts. A relatively simple way to look after the needs of children from a first marriage is through a series of tax-free gifts. You may currently give $13,000 annual gifts to as many recipients as you choose without incurring gift tax liability. So, if you're relatively young, you might use this provision to begin transferring assets to your children (and possibly your grandchildren), presuming you can afford to gift that much. Over a decade or two, you could help your offspring build substantial savings. But your early death would undercut this strategy, and it's important to consider who's getting the money. For example, making yearly gifts to both a child and the child's spouse would enable you to give more but might put money in the hands of a son- or daughter-in-law who later divorces your child.

3. Estate executors. In simple estate planning situations, it often makes sense to choose a spouse or other trusted family member as estate executor. Particularly if that person stands to inherit a substantial part of your assets, he or she is likely to be conscientious about following the provisions of wills and trusts and making sure your wishes are carried out. But that approach isn't likely to work in a blended family. A new spouse or one of your children will have different interests and may not be able to agree with other family members. Unless you want a judge to sort out the mess, it's generally better to appoint an independent third party. Moreover, a professional acting as executor may provide other valuable

(Continued on page 4)

Back to School Basics

If you have a child heading off to college in the fall, either newly enrolled or returning, the summer preceding is filled with a flurry of activity. In addition to outfitting the dorm room and price shopping textbooks, there are a few other tasks worth pursuing. Taking the time to complete them now could you save you hours of time and aggravation later.

As an "adult" your 18 year old will now be in charge of their own financial, medical, and educational information. If your child becomes incapacitated, you have no immediate recourse to step in unless you have the proper documents created ahead of time. A Health Care Power of Attorney, Living Will, and Durable Power of Attorney are all necessary to avoid this problematic situation. Making sure you have copies of important documents kept at home is another consideration.

Additionally, decisions regarding your child's personal property coverage, healthcare, and money management all need to be given some thought. As your wealth manager, it is my job to make sure you are well prepared for all of life's eventualities. I'd be happy to ensure your child's first leap from the nest goes smoothly. Please call our office to discuss.

John

401(k) Alternatives For Business Owners

If you have fewer than 25 employees in your small business, a 401(k) plan may not be right for you. But if your business offers no retirement plan at all, you could lose out in attracting the most qualified job candidates. One or more of these alternatives might be a better fit for your situation.

Simplified Employee Pension (SEP IRA). A SEP IRA is low cost and low maintenance.

- The employer makes all of the contributions; employees can't add to their accounts.
- The plan must cover all eligible employees.
- There is no "plan document."
- You don't have to file annual reports with the IRS.
- Contributions are tax deductible.
- Contributions can vary from year to year. So if you hit a lean spell, you aren't locked in.

Savings Incentive Match Plan for Employees (SIMPLE IRA). For a business with fewer than 10 employees, the SIMPLE IRA is a great starter plan.

- Your contribution is required; employees have the option of contributing.
- But you can't sock away as much for yourself as you can with a SEP IRA, which for 2010 allows a maximum contribution of $49,000. SIMPLE IRA contributions are normally capped at $11,500 ($14,000 for those 50 or older at year's end) plus an employer matching contribution that can't exceed 3% of salary.
- Don't confuse the SIMPLE IRA with the SIMPLE 401(k), which is like a traditional 401(k) plan but with higher fees and less flexibility.

Profit-Sharing Plan. This gives each employee a slice of the company's earnings.

- An overall annual contribution, based on the company's performance, is apportioned to individual accounts according to each employee's salary.
- Contributions are discretionary and tend to vary from year to year.
- A business of any size may use a profit sharing plan and can combine it with other retirement plans.
- Businesses with profit-sharing plans must file IRS Form 5500 each year.
- Administrative costs may be higher than under more basic plans, because this plan must perform a non-discrimination test to ensure it doesn't favor highly compensated employees.

Defined-Benefit Plan. This is the most costly, complex plan for small businesses, but it has one big potential advantage—it lets you make very large contributions that can quickly build your nest egg. You're now allowed to fund a maximum annual retirement benefit of $195,000.

- Your contributions are mandatory.
- You can't decrease benefits retroactively.
- Defined-benefit plans are available to businesses of any size and can be combined with other retirement plans.
- Requires filing an IRS Form 5500 with a Schedule B each year.

The Schedule B must be signed by an enrolled actuary, who will calculate contribution amounts based on your employees' ages and the target benefit. ●

Retiree Relocation: Tax-Friendly States

Are you thinking about pulling up stakes when you retire? You may want to move to a state with warm temperatures and lots of sunshine, but there's also another kind of climate to consider—the tax climate. State taxes as well as federal levies can take a big bite out of retirement income, and some states devour decidedly more than others do. Here are several factors to take into account.

State income taxes. Seven states—Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming—have no state income tax, and New Hampshire and Tennessee tax only investment dividend income that exceeds specified limits. However, many other states and the District of Columbia provide tax breaks for retirees, so you shouldn't automatically assume a no-tax state will be the best choice.

Retirement income. Most states that normally tax income provide partial exemptions for pensions. Even better, 10 states fully exempt income received from federal, state, or military pensions. And in Pennsylvania and Mississippi, all retirement income, including distributions from 401(k)s and IRAs, is state tax-free. Some other states impose high income tax rates on retirement income, however, with California leading the way at 9.55% on income of less than $1 million.

Social Security benefits. Up to 85% of the Social Security benefits you receive may be subject to federal income tax. However, the seven no-tax states, 27 others, and Washington, D.C. don't tax Social Security, though other special rules may apply. For instance, in Colorado, New Mexico, and Utah, you must add back a portion of Social Security benefits not taxed on a federal level when determining your eligibility for certain state income tax breaks.

11 Important Financial Ideas For 2011

With some astute advance planning, you may be able to improve your financial fortunes in 2011. Here are, appropriately enough, 11 timely tips to consider.

1. Revise your estate plan. Under the 2010 Tax Relief Act, the federal estate tax has returned after a one-year repeal. For 2011 and 2012, an estate can benefit from a $5 million exemption and a top tax rate of 35%, among other changes. Meet with your estate planner to consider ways to maximize the benefits.

2. Pay attention to other taxes, too. Although favorable tax rates on income, dividends, and capital gains have also been preserved for 2011 and 2012, there's no reason to pay more tax than you have to. Look for strategies that might postpone income to years when you expect to be in a lower tax bracket or help in other ways. One possibility is to invest in stocks that pay no dividends but have the potential for long-term growth.

3. Consider (even now) converting your IRA to a Roth. Though you missed the one-time chance to put off and spread out taxes due on a conversion, a Roth IRA might still be a boon to your long-term prospects, delivering tax-free income during retirement.

4. Max out your 401(k) contributions. It's not new advice, but it continues to make sense to put as much as you can into your retirement plan at work. You'll shelter income from being taxed at the new, higher rates and put tax-deferred compounding to work. The maximum deferral for 2011 is $16,500, plus you can add a $5,500 "catch-up" contribution if you're age 50 or older.

5. Leverage low interest rates. Loan rates are plumbing historic depths, making inexpensive borrowing a viable financial strategy. You could refinance a car loan or mortgage or borrow to pay college costs. Just don't make the mistake of carrying more debt than you can afford.

6. Take advantage of low asset values. Your investment account balances may be a shadow of their former selves, and home values, too, have suffered. But you could benefit from those reduced assets if you're trying to shift value out of your taxable estate. With planning vehicles such as a grantor retained annuity trust, or GRAT, for example, you could now transfer more of your estate without taxes, and low interest rates only increase your advantage.

7. Protect against inflation. Although no one can be sure about future economic conditions, it's wise to take steps to guard against the threat of inflation. Inflation can steadily erode your savings and reduce your purchasing power. First and foremost, ensure that your portfolio is properly diversified and includes inflation-defensive components. Some possible additions are precious metals like gold, certain commodities and Treasury Inflation Protected Securities (TIPs). Caveat: Maintain an investment approach that suits your personal tolerance for risk.

8. Be ready for a rough ride. Though stock market volatility recently retreated to more normal levels, it could pick up again later this year, and a well-diversified portfolio can help you ride out market ups and downs by including a broad range of assets, some of which may gain value while others fall. (Diversification, of course, can't guarantee against losses in a declining market.)

9. Don't let a weakening dollar sap your investments. Big federal budget deficits and slow economic growth could make the U.S. dollar less popular, and if its value declines, so will your purchasing power (particularly when you're buying imported goods). But when the dollar falls, other currencies rise, and you could invest in multinational corporations (that generate some of their income outside the "dollar zone") or in foreign stocks that pay dividends in euros or yen, for example. You might even commit a small portion of your portfolio to gold as a hedge.

10. Insure your future. Having adequate insurance—with policies for health, life, cars, your home, and long-term care—can protect you and your loved ones from unforeseen events, and early in the year is a great time to review your coverage and make needed adjustments.

11. Make sure credit cards are your financial allies, not enemies. Plastic is almost a necessity these days, and there's nothing wrong with using a credit card for online purchases or to keep tabs on your expenses. But unless you pay off balances every month, you could spend a small fortune on interest charges—even now, when most rates are low. And if you have old credit card debt, why not come up with a plan for retiring it as soon as possible? We could help with this or with any other smart financial moves you're considering this year.●

Sales tax. These levies are often overlooked when retirees contemplate a move. On the plus side, five states—Alaska, Delaware, Montana, New Hampshire, and Oregon—currently have no sales tax, and other states may exempt food, medicine, and other necessities. But California has an 8.25% rate, and many cities and counties pile on additional sales tax charges. In Chicago and Los Angeles, you'll pay a combined rate of 9.75%—the nation's highest. And things could get worse. In 2009, 649 U.S. cities imposed new sales taxes or increased existing rates, while only 192 reduced sales tax rates (Source: Vertex Inc.).

Property taxes. The property tax burden varies widely throughout the country and even within states. The five states with the lowest median property taxes are Louisiana, Alabama, West Virginia, Mississippi, and Arkansas, while New Jersey, New Hampshire, Connecticut, New York, and Rhode Island have the highest.

Of course, tax rates aren't likely to be your only reason for choosing a particular retirement location. But it can't hurt to factor in these very real costs when planning your move. ●

Not All ETFs Are Tax-Efficient Anymore

It used to be simple. One reason to consider investing in exchange-traded funds (ETFs) was that you would make out better at tax time than if you put your money into standard index mutual funds. But as ETFs have thrived, with exponential growth since their debut two decades ago, they've branched out from stocks to bonds and now to commodities and currencies. While those more esoteric ETFs provide a convenient way for ordinary investors to participate in hard-to-tap markets, they also bring tax complications that can hit you hard even if you hold on to your shares.

Standard equity ETFs resemble index mutual funds, in that both may be designed to track a stock benchmark. But when investors redeem mutual fund shares, the fund manager may need to sell holdings to come up with the cash, and that can generate taxable capital gains that the fund passes on to shareholders. ETFs, in contrast, are more like stocks; they're traded on exchanges, and most transactions involve existing shares. So, there's less selling of the assets in the fund and fewer immediately taxable gains, though you'll still owe taxes if you sell your shares at a profit.

Many newer ETFs, however, are tied to the value of commodities or currencies, and those may be taxed in many entirely different ways. Such funds are often organized as trusts or limited partnerships, complicated structures that may generate several kinds of taxes. And these ETFs can own a very wide range of assets, from actual currencies and commodities to all kinds of derivatives—futures, forward contracts, options—that may be subject to various levels and timing of taxes. In many cases, you end up paying more than the 15% rate that applies to long-term capital gains of stock ETFs and mutual funds.

Sometimes, you'll even be taxed on gains the fund hasn't realized. The IRS may require a commodities fund that holds futures contracts, for example, to "mark to market" its positions in those contracts at year's end— and you may be responsible for gains that don't yet exist. You could also be on the hook if you own shares in a gold ETF that holds bullion or gold coins. Shareholders of those funds are subject to a tax on "collectibles"—at a 28% rate for long-term gains. The earnings of currency funds, meanwhile, may be taxed as interest, at ordinary income rates of as much as 35%.

In most cases, potential tax liability shouldn't be a deal-breaker when considering an investment. Yet it is a consideration, and it's a factor we look at when working with clients to construct investment portfolios that fit their financial goals, investing timetable, and investment risk-tolerance. If you wonder whether ETFs belong in your investment mix—and what kind of taxation you might face—please make an appointment so we can discuss these issues. ●

You should consider an exchange traded fund's investment objectives, risks, charges, and expenses carefully before you invest. The fund's prospectus contains this and other information about the fund and can be obtained from our office or from the fund company directly.

Five Financial Snags

(Continued from page 1)

benefits to the estate.

4. Power of attorney. A power of attorney is a valuable estate planning tool, but your intentions may be thwarted if the wrong person gets this responsibility or it isn't handled properly. This legal document establishes the right for another person to act on your behalf, and that person could use it to transfer assets to a trust, for example, or to make annual tax-free gifts—basically, to take over any tasks you may be unwilling or unable to handle yourself. This authority can be either broad or specific—for example, it could be limited to selling securities or other possessions. Here, too, it often makes sense to give this power to a family member, but in a blended family that could lead to conflicts. Appointing someone from outside the family may be preferable, and it generally makes sense to have a durable rather than a general power of attorney.

5. Trusts. Various trusts can help sort out assets and interests for blended families. But even some trusts frequently used in such situations could cause problems. For example, a "qualified terminable interest property" (Q-TIP) trust can divide your assets between a surviving second spouse and the children from your first marriage. Typically, the spouse gets to use the trust income, while the children, as trust beneficiaries, receive the trust assets after the spouse dies. But this arrangement may spark disputes between the spouse and the children regarding management of trust assets, with the spouse possibly emphasizing current income while the children preferring asset appreciation. One solution is to give an independent trustee the ability to make adjustments so that everyone is treated fairly.

The bottom line is that the special dynamics of blended families make careful estate planning imperative. We can work with you and your attorney to create planning strategies and vehicles that serve the needs of you and your family. ●